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**ESS COLLEGE OF BUSINESS'  
ADMINISTRATION OF THE TITLE IV STUDENT  
FINANCIAL ASSISTANCE PROGRAMS**

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**FINAL AUDIT REPORT**



*Control Number ED-OIG/A06-A0015  
August 2001*

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effectiveness, and integrity of the  
Department's programs and operations.*



*U.S. Department of Education  
Office of Inspector General  
Dallas, Texas*

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# **NOTICE**

**Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determination of corrective action to be taken will be made by the appropriate Department of Education officials.**

**In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.**

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

AUG 29 2001

THE INSPECTOR GENERAL  
Control Number ED-OIG/A06-A0015

Mr. Steven B. Friedheim, President  
ESS College of Business  
4849 Greenville Avenue, Suite 200  
Dallas TX 75206-4125

Dear Mr. Friedheim:

This is our audit report, **ESS College of Business' Administration of the Title IV Student Financial Assistance Programs**. The report incorporates the comments you provided in response to a draft report which was provided to you. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following U.S. Department of Education official, who will consider them before taking final Departmental action on the audit:

Mr. Greg Woods, Chief Operating Officer  
Student Financial Assistance  
ROB-3, Room 4004  
7<sup>th</sup> and D Streets, SW  
Washington, DC 20202-5132

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, we request receipt of your comments within 30 days.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemption in the Act.

Please refer to the above audit control number in all correspondence relating to this report.

Sincerely,

  
for Lorraine Lewis

Enclosure

## EXECUTIVE SUMMARY

ESS College of Business (ESS), located in Dallas, Texas, did not qualify as an eligible institution for participation in the Title IV, Student Financial Assistance programs authorized by the Higher Education Act of 1965, as amended (HEA). ESS was ineligible to participate in the Title IV programs from June 1, 1999, through May 31, 2000, because it received more than 90 percent of its revenue from Title IV sources during its fiscal year ended May 31, 1999. During the ineligible period, ESS received approximately \$4.4 million in Title IV funds. After we informed ESS that it had not met the 90 Percent Rule, the school provided us with documents that showed it had awarded institutional scholarships to 132 students. Based on our analysis of the students' files, we determined that only one of the 132 students received a valid institutional scholarship in the fiscal year ended May 31, 1999.

We found that ESS lacked administrative capability because it failed to provide timely access to fiscal records, inappropriately disbursed \$183,213 of Title IV aid for students without adequately documenting dependency overrides, did not obtain authorization from students to retain Title IV credit balances, and incorrectly classified apartment charges as non-institutional costs for calculating refunds.

Pertaining to other matters, we determined that ESS did not maintain documentation of Title IV loan cancellation notifications and disbursed \$517 in Federal Pell Grant funds to an ineligible student.

Subsequent to the end of our fieldwork, the Department revoked ESS' provisional certification to participate in the Title IV programs on March 27, 2001. ESS requested reconsideration of that decision, but the request was denied. ESS closed on June 29, 2001.

We recommend that the Chief Operating Officer for Student Financial Assistance:

1. Determine whether ESS was in compliance with the 90 Percent Rule for its fiscal year 2000. If ESS was not in compliance, require the institution to return any Title IV funds disbursed after May 31, 2000.
2. Require ESS to return to lenders or the Department \$4,439,651 in Title IV funds (\$4,379,550 received from June 1, 1999, through May 31, 2000, for failure to meet the 90 Percent Rule, and \$60,101<sup>1</sup> for failure to document the basis for dependency overrides).
3. Require ESS to perform a 100 percent review of students not included in our audit who had a dependency override or a refund calculation performed, return to lenders or the Department

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<sup>1</sup> These are unduplicated questioned dollars. ESS disbursed \$60,101 of the total questioned amount for our Administrative Capability finding before the school became ineligible on June 1, 1999. The remaining \$123,112 (\$183,213 less \$60,101) were disbursed after ESS became ineligible and are included in our finding on the 90 Percent Rule.

any unallowable Title IV funds disbursed but not recovered through Recommendation 2, and have ESS' Independent Public Accountant verify the school's review for accuracy.

ESS provided narrative comments and five exhibits containing documentation in response to our draft report issued in May 2001. ESS' narrative comments are included in their entirety in Appendix B. We summarized ESS' comments and provided our response following each finding. The exhibits have been provided to the Department of Education Action Official. Our analysis of ESS' comments and the documentation provided to support those comments did not persuade us to change our overall conclusions or recommendations for any of the findings.

## AUDIT RESULTS

### FINDING NUMBER 1 ESS DID NOT COMPLY WITH THE 90 PERCENT RULE

ESS did not qualify as an eligible institution for participation in the Title IV, Student Financial Assistance programs, because it received over 90 percent of its revenue from Title IV sources during its fiscal year ended May 31, 1999. As a result, the school was ineligible to participate in the Title IV programs for the period June 1, 1999, through May 31, 2000. ESS disbursed \$4,379,550 of Title IV funds during the ineligible period.

ESS reported in the notes to its May 31, 1999, audited financial statements that it met the 90 Percent Rule with 79.17 percent of its revenue from Title IV sources. We determined that the school could not support all of the amounts used in the calculation. The calculation included cash revenue from ineligible sources and incorrectly excluded bookstore and apartment cash revenue that should have been included in the calculation. Based on our analysis, ESS received 93.58 percent of its cash revenue from Title IV sources for the period June 1, 1998, through May 31, 1999.

#### **Proprietary Schools Are Required to Generate at Least 10 Percent of Their Revenue from Non-Title IV Sources**

Section 102(b) of the HEA specifies that a proprietary institution of higher education is "a school that . . . has at least 10 percent of the school's revenues from sources that are not derived from funds provided under title IV, as determined in accordance with regulations prescribed by the Secretary." Conversely, no more than 90 percent of total revenue may be derived from Title IV programs. This institutional eligibility requirement became effective October 1, 1998, and is codified in 34 CFR § 600.5(a)(8). The regulations also provide the formula, at 34 CFR § 600.5(d)(1), for assessing whether an institution has satisfied the requirement. Pursuant to 34 CFR § 600.5(d)(2)(i), amounts used in the formula must be received by the institution during its fiscal year.

The formula is as follows:

Title IV, HEA program funds the institution used to satisfy tuition, fees,  
and other institutional charges to students.

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The sum of revenues generated by the institution from: Tuition, fees, and other institutional charges for students enrolled in eligible programs as defined in 34 CFR [§] 668.8; and activities conducted by the institution, to the extent not included in tuition, fees, and other institutional charges, that are necessary for the education or training of its students who are enrolled in those eligible programs.



## ESS Could Not Support Its 90 Percent Rule Calculation

ESS' audited financial statements for its fiscal year ended May 31, 1999, showed that the school met the 90 Percent Rule with 79.17 percent of its revenue from Title IV sources. ESS provided us with the amounts it used in the calculation (see Table). We found that ESS had not maintained records to support all of the amounts. The school's Chief Executive Officer informed us that after the audited financial statements were issued, she disposed of the school's general ledgers for that fiscal year. We also were unable to determine the accuracy of the calculation from a review of the school's audited financial statements or the working papers of the Independent Public Accountant who performed the financial statement audit.

Because ESS could not support its calculation, we analyzed deposits to and withdrawals from the seven bank accounts that ESS used during its fiscal year ended May 31, 1999, and determined that ESS received 93.58 percent of its revenue from the Title IV programs. The following Table shows ESS' calculation and our calculation based on the amounts we obtained from the seven bank accounts and other documents.

TABLE  
90 Percent Rule Calculations for June 1, 1998, through May 31, 1999

	ESS Calculation	OIG Calculation
Title IV Cash Revenue	\$ 4,249,193	\$ 4,142,798
Less:		
Refunds	(547,246)	(373,648)
Federal Work-Study	0	(22,022)
Funds Paid to Students	(93,834)	(94,507)
Bookstore Income	(422,132)	0
Apartment Income	(366,143)	0
<b>Net Title IV</b>	<b>\$ 2,819,838</b>	<b>\$ 3,652,621</b>
Total Cash Revenue	\$ 4,736,935	\$ 4,483,069
Less:		
Refunds	(547,246)	(373,648)
Federal Work-Study	0	(22,022)
Funds Paid to Students	0	(94,507)
Ineligible Revenue	0	(89,696)
Accts. Receivable Adjustment	(627,979)	0
<b>Net Total</b>	<b>\$ 3,561,710</b>	<b>\$ 3,903,196</b>
<b>Title IV Percentage = Net Title IV/Net Total</b>	<b>79.17%</b>	<b>93.58%</b>

See Appendix A for additional information on the amounts included in the table.

## **Institutional Scholarships**

After we informed ESS that the school had not met the 90 Percent Rule, ESS provided us with documents that showed the school awarded \$169,199 of institutional scholarships to 132 students for its fiscal year ended May 31, 1999. ESS stated that it met the 90 Percent Rule when these institutional scholarships were included in the calculation. ESS had not previously included institutional scholarships in its 90 Percent Rule calculation. The scholarships were not accounted for or disclosed in ESS' audited financial statements for that year, nor had ESS claimed the scholarships as a business expense for income tax purposes.

We reviewed the financial aid and academic files for all 132 students and found that ESS awarded only one of the students a valid institutional scholarship during the fiscal year ended May 31, 1999. ESS waived \$5,510 of its tuition charge for this one student based on an agreement with Dallas County under the Workforce Investment Act. ESS granted two other students tuition waivers under the agreement with Dallas County, but not during the fiscal year ended May 31, 1999.

In October 1999, the Department announced standards for evaluating institutional scholarships until new regulations became effective on July 1, 2000. The Department stated that it would

continue to examine institutions closely to determine whether the institutional loans and scholarships are valid . . . . Institutional scholarships will only be valid for this purpose if a substantial number of the comparable students at the institution are paying the stated institutional charges without receiving scholarships, and the scholarships do not otherwise appear to be artificial transactions.

We determined that the remaining 129 students had not received valid institutional scholarships. The scholarships were not supported by ledger entries obtained previously during our fieldwork, were not on authentic scholarship forms, and/or were not consistent with other student information.

## **Title IV Funds Received by ESS from June 1, 1999, through May 31, 2000**

Institutions that fail to satisfy the 90 Percent Rule lose their eligibility to participate in the Title IV programs on the last day of the fiscal year covering the period that the institution failed to meet the requirement. As a result, ESS lost its eligibility to participate as of May 31, 1999. ESS received \$4,379,550 of Title IV funds (\$949,250 in Federal Pell Grant, \$51,653 in Federal Supplemental Educational Opportunity Grant [FSEOG], \$38,000 in Federal Work-Study [FWS], \$1,976,489 in William D. Ford Federal Direct Loan [Direct Loan], and \$1,364,158 in Federal Family Education Loan Program [FFELP]) for the period June 1, 1999, through May 31, 2000.

## RECOMMENDATIONS

We recommend that the Chief Operating Officer for Student Financial Assistance:

- 1.1 Determine whether ESS was in compliance with the 90 Percent Rule for its fiscal year ended May 31, 2000. If ESS was not in compliance, require the institution to return any Title IV funds disbursed after May 31, 2000.
- 1.2 Require ESS to return \$1,364,158 in FFELP funds to lenders and \$3,015,392 in Federal Pell, FSEOG, and Direct Loan funds to the Department that it received from June 1, 1999, through May 31, 2000.

## ESS' COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE

ESS' comments did not persuade us to change our conclusion that the school did not comply with the 90 Percent Rule for its fiscal year that ended May 31, 1999. The school closed on June 29, 2001, and we dropped the recommendation in our draft report that the Department terminate ESS if the Department determines the school did not comply with the 90 Percent Rule for the fiscal year ended May 31, 2000. We did not change the other recommendations.

ESS disagreed with our draft report conclusion and stated that it had complied with the 90 Percent Rule for its fiscal years 1999, 2000, and 2001. ESS provided the following general comments about the audit process and specific comments about why it disagreed with our 90 Percent Rule calculation. Our response follows each of the school's comments.

### General Comments on the Audit Process

ESS Comments. ESS questioned the "appropriateness of an audit experience that was seriously flawed." ESS said that the draft report contained a statement that it was pre-decisional and subject to revision and a recommendation that the Department determine if ESS was in compliance with the 90 Percent Rule for its fiscal year 2000 (ESS' 2000 fiscal year ended May 31, 2000). The school questioned the logic of providing comments to the draft report because "other members of the Department have already decided the issues under consideration and terminated the College's eligibility to participate in the Title IV, HEA programs."

OIG Response. We disagree that the audit was flawed. ESS' eligibility was not terminated because the Department determined the school failed to comply with the 90 Percent Rule. The Department's decision on March 27, 2001, to revoke ESS' provisional certification to participate in the Title IV programs was made after the Department evaluated the actions and integrity of ESS in its response to our audit inquiries about the school's compliance with the 90 Percent Rule. The Department concluded from its evaluation that ESS had failed to fulfill its fiduciary responsibilities necessary for continued participation in the Title IV programs. The Department's letter advising the school that its provisional certification was revoked stated: "ESS intentionally manipulated its student and financial data to attempt to deceive the

Department into believing that ESS complied with the so-called '90-10 rule'." The revocation letter is included in its entirety in Appendix C.

Our audit of ESS' 90 Percent Rule calculation covered only the school's fiscal year that ended May 31, 1999. Since we did not review the calculation for the fiscal year that ended May 31, 2000, our draft report conclusion did not address that year. However, we did recommend that the Department determine if ESS complied with the Rule for the 2000 fiscal year. The Department had not made such a determination at the time it revoked ESS' provisional certification.

ESS Comments. ESS also claimed that the draft report "totally ignores the effect of the advice given by the OIG auditor who suggested a search of the files to locate and document institutional scholarships, which could be used to show that the institution was in compliance with the so-called 90 Percent Rule." ESS listed a series of draft 90 Percent Rule calculations that we had provided to the school during our audit. The school said that the lack of specificity regarding several elements used in the 90 Percent Rule calculation created an impossible situation for institutions attempting to comply with the Rule and that confusing and contradictory statements by the auditor "led the institution to include its scholarships in its 90/10 calculations . . ." ESS said "it was acting in good faith by identifying scholarship recipients as requested."

OIG Response. ESS could not support its calculation and failed to provide us with accounting records during our audit fieldwork that we could use to perform the calculation. As a result, we had to analyze all the deposits to and withdrawals from seven ESS bank accounts to perform the calculation. To ensure the accuracy of this labor-intensive process, we provided ESS officials with copies of our interim calculations. We requested that ESS review the calculations and provide documentation for any amounts which we had not considered.

ESS responded by providing us with documents that showed it awarded almost \$170,000 of institutional scholarships to 132 students during the 1999 fiscal year. Based on our review of the scholarship forms and student files, we determined that only one of the 132 students had received a valid institutional scholarship in the 1999 year (two others received valid scholarships but in other years). The remaining 129 students had not received an institutional scholarship of any type in 1999 or any other year. We determined that the scholarship certificates ESS provided were not authentic and that other documents provided had been manipulated to make it appear the students had received the scholarships. We disagree with ESS' statement that it acted in good faith by providing us with such documents in an attempt to support compliance with the 90 Percent Rule.

ESS Comments. ESS contended that the OIG acted in bad faith from January 1 through March 27, 2001, (the provisional certification revocation date) by directing the Department not to provide any Title IV reimbursement to the school.

OIG Response. We did not direct the Department to withhold reimbursement to the school.

## **Compliance for Fiscal Years 1999 through 2001**

ESS Comments. ESS contended that it complied with the 90 Percent Rule for fiscal years 1999, 2000, and 2001. ESS provided Exhibits 1 and 2 to support its narrative comments. These exhibits contain calculations prepared by ESS that show the Rule was met for the fiscal year ended May 31, 2000, and for the partial fiscal year period from June 1, 2000, through March 27, 2001.

An independent public accountant using agreed-upon procedures verified the amounts used in ESS' calculations to the general ledger and corresponding bank accounts for the 2000 fiscal year. The accountant made no representation regarding the sufficiency of the procedures and did not express an opinion on compliance. The calculation for the partial 2001 fiscal year contains the typed statement "Prepared by (OIG auditor) 6/21/01" with the word "Formula" handwritten beside the statement.

OIG Response. Our audit was limited to ESS' compliance with the 90 Percent Rule for the fiscal year ended May 31, 1999. ESS' response to our draft report did not contain any calculations for that year. We did not audit ESS' compliance with the Rule for either the 2000 or the partial 2001 years. We also did not prepare the calculation contained in Exhibit 2 as indicated by the ESS' typed statement on the calculation.

ESS Comments. ESS stated that its fiscal year 1999 ended on May 31, 1999, and that "the law and guidance in effect at that time is what should be applied and not the law or interpretations in effect on or after July 1, 2000."

OIG Response. We used the statutory and regulatory provisions that were in effect for the school's 1999 fiscal year.

## **Bookstore Income**

ESS Comments. ESS stated that it had properly excluded bookstore income from the 90 Percent Rule calculation because the income was not derived from an institutional charge. ESS said the issue in determining if a charge is institutional or non-institutional, as explained in a 1999 Policy Bulletin, is not whether a school actually charged students for books but whether the students had a "real and reasonable opportunity" to purchase books from places other than the school. ESS identified three nearby bookstores and a bookstore on the Internet where it said students could purchase books. ESS also said students were told they could purchase books elsewhere and the students could obtain a cash advance from the school to do so.

ESS further stated that "Up to and including the exit audit interview, the OIG auditor accepted these facts . . . . No valid basis exists for this last minute change in position."

OIG Response. The 1999 Policy Bulletin was issued by the Department to provide guidance to schools for classifying institutional charges for refund calculations. ESS followed this guidance by classifying its book charges as institutional charges and including the charges in its refund calculations. We agree with ESS' classification of the book charges for this purpose. We do not

agree with ESS' classification of book charges as non-institutional charges and the resultant exclusion of income derived from those charges in its 90 Percent Rule calculation.

The 1999 Policy Bulletin explains that: "An institution would not be able to demonstrate that a student had a real and reasonable opportunity to purchase his or her required course materials from alternative sources if one of the following is true:

1. When financial aid is available to the institution for disbursement to the student, the institution does not make those funds available to the student in time to purchase the required material from another vendor before those materials are required for academic purposes;
2. The institution's practices do not allow or discourage a student (e.g. the use of vouchers that are only good at the campus bookstore or the late disbursement of funds to students to pay for non-institutional costs) from exercising his or her option to purchase the required course materials from another vendor; or
3. The institution has the student sign a statement saying that the student has the option to purchase course material from someplace other than the school, but the institution is unable to document that an option truly existed."

We concluded that students did not have a "real and reasonable" opportunity to purchase books at other locations prior to starting classes. ESS did not make funds available to students prior to class start dates. ESS included book charges in students' award letters and the students signed vouchers at the school bookstore for the books they needed. The students' accounts were charged for the purchase price of the books.

Our audit work and conclusions are subject to review and revision prior to being finalized. Based on our completed reviews of sample student files and the school's 90 Percent Rule calculations, we concluded that ESS correctly classified book charges as institutional charges for refund calculations, but incorrectly classified the charges as non-institutional charges for the 90 Percent Rule calculation.

### **Apartment Income**

ESS Comments. ESS disagreed that apartment charges were institutional charges and that income derived from the charges should be included in the 90 Percent Rule calculation. ESS quoted the 1999 Policy Bulletin on institutional charges and refunds, which states that non-institutional costs include a "charge to the student's account for room charges that are collected by the school but are 'passed through' to an unaffiliated entity . . . ."

ESS referred to a program review of the school in which ESS said a Department official determined that the apartment charges were a "pass through" and correctly excluded from refund calculations.

OIG Response. We disagree that the apartment charges were a pass-through charge. The 1999 Policy Bulletin states that "all charges for tuition, fees, and room and board (if contracted with

the institution) are always institutional costs.” ESS maintained control of the apartments by entering into lease agreements with selected students and determining the lease charges assessed to the students. ESS set the apartment rental rates with four students being placed in a two-bedroom apartment. Students were required to follow ESS' guidelines, which specified that the school could evict students for cause.

ESS did not provide any documentation that the Department's program review had determined that apartment charges were a “pass-through” charge. Based on our review of the program review report and supporting working papers, we found no evidence that the Department concluded the amounts collected from students for apartment charges met the definition of a pass-through charge.

### **Federal Work-Study**

ESS Comments. ESS referred to 34 CFR § 600.5(d)(2)(ii) that states: “Title IV, HEA program funds included in the numerator do not include . . . Federal Work Study Program funds.” ESS stated that this regulation did not require schools to exclude FWS from the denominator of the calculation. The school stated that “not until July 1, 2000, was any regulation or rule in place that stated that FWS is to be excluded from the denominator, as well.”

OIG Response. Pursuant to 34 CFR § 600.5(d)(1), that was in effect during the period of our audit, schools must include in the numerator only Title IV funds used to satisfy tuition, fees, and other institutional charges to students. This same section states that schools include in the denominator the sum of revenues derived from tuition, fees, and other institutional charges. FWS funds were not used to pay for any tuition, fees, or other institutional charges, and ESS should not have included the funds in either the numerator or denominator of the calculation.

### **Institutional Scholarships**

ESS Comments. ESS said that we had no basis to challenge the legitimacy of the Career Colleges and Schools of Texas (CCST) and the Career Training Foundation (CTF) scholarship programs. ESS stated:

(T)here can be no doubt that ESS actually awarded all of the scholarships that are of issue. The simple issue is whether they can be treated as scholarships awarded for FY 1999 and even if agreement cannot be reached on all scholarship(s) . . . there should be no doubt that some portion of the scholarship revenue can properly be included . . . . This includes, among others, students who enrolled at ESS with scholarship certificates from CCST and CTF that were received and accepted by the College in fiscal year 1999 but as to which ESS did not make the record entry until after the fiscal year ended.

ESS said that it believes \$70,000 in CCST and CTF scholarships should be included in the calculation.

OIG Response. ESS provided no support for the \$70,000 of CCST and CTF scholarships that it now claims should be included in the calculation. Based on ESS' previous claim that it awarded

\$161,000 of CCST and CTF scholarships to 129 students and our finding that none of the scholarships were valid, we have no reason to change our conclusion.

CCST and CTF began providing scholarship certificates annually to high schools in 1997 and 1998, respectively. High schools are instructed to choose graduating seniors to receive the certificates. Each scholarship is valued at \$1,000 when accepted by a participating CCST or CTF school. To receive the scholarship benefit, the high school graduate must enroll in a participating career school and present the scholarship to that school.

We are not questioning the legitimacy of the CCST and CTF scholarship programs, but we are questioning the legitimacy of ESS' claim that it awarded \$161,000 (now \$70,000) of CCST and CTF scholarships to 129 students. Based on our review of ESS' files for the 129 students, we determined that none of the students received either a CCST or CTF scholarship. The files for 14 students did not have a copy of the scholarship and the files for 115 students contained a copy of a purported scholarship that was not the actual scholarship form provided by CCST and CTF for high schools to use. We also have other reasons to question the purported scholarships:

- 12 students were not high school graduates and were never eligible for the scholarships,
- 42 students graduated from Texas high schools before the scholarship program began,
- four students were high school graduates from states other than Texas and yet supposedly received CCST scholarships,
- eight students have scholarships listed in their married name even though they were single and had their maiden name at the time of their high school graduation,
- 61 students had promissory notes in their files signed by the students upon their departure from the school that do not reflect the scholarships, and
- 36 students had collection notices in their files that did not consider a CCST or CTF scholarship.

<p style="text-align: center;"><b>FINDING NUMBER 2</b> <b>ESS LACKED ADMINISTRATIVE CAPABILITY</b></p>
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We found that ESS lacked administrative capability when it failed to provide timely access to fiscal records, inappropriately disbursed \$183,213 of Title IV aid for students without adequately documenting dependency overrides, did not obtain authorization from students to retain Title IV credit balances, and incorrectly classified apartment charges as non-institutional costs for calculating refunds.

Section 498(d) of the HEA authorizes the Secretary to establish administrative capability procedures and requirements for institutions participating in the SFA programs. These



procedures and requirements are codified in 34 CFR § 668.16, which states, among other requirements, that:

To begin and to continue to participate in any Title IV, HEA program, an institution shall demonstrate to the Secretary that the institution is capable of adequately administering that program under each of the standards established in this section. The Secretary considers an institution to have that administrative capability if the institution –

- (a) Administers the Title IV, HEA programs in accordance with all statutory provisions of or applicable to Title IV of the HEA, all applicable regulatory provisions prescribed under that statutory authority, and all applicable special arrangements, agreements, and limitations entered into under the authority of statutes applicable to Title IV of the HEA.

Among the administrative capability factors in 34 CFR § 668.16 that should be considered are whether the institution:

- establishes and maintains all required records;
- shows no evidence of significant problems that affect the institution’s ability to administer the Title IV programs that are identified by oversight agencies; and
- does not otherwise appear to lack the ability to administer the Title IV programs competently.

### **Failure to Provide Timely Access to Fiscal Records**

ESS did not provide timely access to all fiscal records that we requested during our audit fieldwork.

Pursuant to 34 CFR § 668.24(b)(2):

- An institution shall establish and maintain on a **current** [emphasis added] basis -
- (i) Financial records that reflect each HEA, title IV program transaction; and
  - (ii) General ledger control accounts and related subsidiary accounts that identify each title IV, HEA program transaction and separate those transactions from all other institutional financial activity.

Further, 34 CFR § 668.24(f) states in regard to examination of records:

- (1) An institution that participates in any title IV, HEA program . . . shall cooperate with . . . the Department of Education’s Inspector General . . . in the conduct of audits, investigations, program reviews, or other reviews authorized by law.
- (2) The institution . . . must cooperate by – (i) Providing timely access, for examination and copying, to requested records, including but not limited to computerized records . . . and to any pertinent books, documents, papers, or computer programs . . . .

The school's Chief Executive Officer informed us in August 2000 that after the audited financial statements were issued she disposed of the school's general ledgers for fiscal year 1999. ESS also asserted in a management representation letter to us on September 27, 2000, that all records provided are accurate and complete. However, ESS' response to our draft report included an exhibit that the school stated was its general ledger for the 1999 fiscal year. ESS did not make this general ledger available to us until almost nine months after our request. Based on our review of the general ledger, we concluded that it could not be used to support the 90 Percent Rule calculation.

### **Dependency Overrides Without Adequate Documentation**

ESS inappropriately disbursed \$183,213 of Title IV aid for students without adequately documenting dependency overrides. ESS used professional judgment in the form of a dependency override for 65 (37 percent) of 175 randomly selected students awarded Title IV aid from July 1, 1998, through May 31, 2000. In testing the use of professional judgement, we expanded our sample from 50 to 175 students. Some students had dependency overrides in more than one award year during that period. In total, ESS performed 77 dependency overrides for the 65 students. We determined that 27 (35 percent) of the 77 dependency overrides were not documented or the documentation ESS obtained did not support that the students were independent. Parent income and asset information was not available for 26 of these 27 dependency overrides.

Financial Aid Administrators (FAAs) are allowed by Section 479A of the HEA to, among other things, use their discretion or professional judgment on a case-by-case basis either to increase or decrease one or more of the financial elements used to calculate the Expected Family Contribution or to change a student's status from dependent to independent. The HEA requires FAAs to adequately document the basis for the professional judgment action and how the action relates to each individual student's special circumstance.

ESS did not have a written policy on dependency overrides. ESS officials explained that the school's practice was to document dependency overrides by obtaining statements from students that they supported themselves. The FAA told us she was responsible for approving and performing the dependency overrides. ESS admissions representatives, who helped recruit students for the school, were also involved in the process. An ESS admissions representative stated that if parental information was not available for dependent students, he advised them that a dependency override could be performed if they provided a statement that they supported themselves. The admissions representative said that if a student requested assistance, he helped the student complete the statement regarding support and forwarded it to the FAA.

ESS agreed that it needed to strengthen its procedures for documenting dependency overrides. After we notified the school of our sample results, the FAA sent a memorandum to the school's admission representatives that identified procedures for determining when a dependency override is warranted and the documentation required before a dependency override would be approved. The documentation included the tax return of the parent and student, and receipts, cancelled

checks, and other proof of support. We did not determine whether the new procedures were being followed.

We determined that ESS disbursed \$60,101 of the \$183,213 of Title IV funds from July 1, 1998, through May 31, 1999. The remaining \$123,112 (\$183,213 less \$60,101) was disbursed after ESS became ineligible on June 1, 1999, and is included in Finding Number 1. The \$60,101 includes \$16,272 of Federal Pell Grant, \$22,371 of Direct Loan, and \$21,458 of FFELP funds.

### **Credit Balances Retained Without Students' Authorization**

ESS had not obtained written authorization from students to retain credit balances of Title IV funds for over 14 days for nine (18 percent) of 50 sample students in violation of the regulations. ESS maintained these credit balances for an average of 87 days.

Under 34 CFR §§ 668.164(d) and (e), an institution may use Title IV funds to satisfy current charges. The regulations explain that an institution may retain Title IV funds to satisfy additional current charges if an appropriate authorization from the student is received. Without an appropriate authorization, the institution is to pay any resulting credit balance directly to the student or parent as soon as possible, but no later than 14 days after the balance occurred. An institution may not require or coerce a student or parent to provide that authorization and must allow them to cancel or modify the authorization at any time [34 CFR § 668.165(b)(2)].

### **Apartment Charges Not Included in Refund Calculations**

ESS incorrectly considered apartment charges paid by students to the school as a pass-through expense rather than an institutional charge. As a result, ESS did not include the charges in its refund calculations. Although our sample review of 27 refund calculations did not identify any material refund calculation errors, the potential exists that a material error could occur if all institutional charges are not included in refund calculations.

Pursuant to 34 CFR §§ 668.22(c)(1) and (d)(1), institutional charges that need to be considered in refund calculations are tuition, fees, room, board, and other charges assessed to the student by the institution. Room charges that are passed through the institution from an entity that is not under the control of, related to, or affiliated with the institution are not considered institutional charges [34 CFR §§ 668.22(c)(6) and (d)(4)]. The apartment charges are not a pass-through expense because ESS maintained control of the apartments by entering into lease agreements with selected students and determining the lease charges assessed to the students. For its fiscal year ended May 31, 1999, ESS paid apartment complexes \$507,133 for a specified number of apartments that the school in turn leased to students for \$366,243.

## RECOMMENDATIONS

We recommend that the Chief Operating Officer for Student Financial Assistance require ESS to:

- 2.1 Return to lenders or the Department \$60,101 (\$16,272 in Federal Pell Grant, \$22,371 in Direct Loan, and \$21,458 in FFELP funds) in Title IV aid disbursed to the students without adequate documentation of dependency overrides.
- 2.2 Perform a 100 percent review of students not included in our audit who had a dependency override or a refund calculation performed, return to lenders or the Department any unallowable Title IV funds disbursed but not recovered through Recommendation 1.2, and have ESS's Independent Public Accountant verify the school's review for accuracy.

## ESS' COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE

ESS' comments did not persuade us to change our conclusion that the school lacked administrative capability. We dropped our recommendation that the Department initiate appropriate administrative action against ESS because the school closed after our draft report was issued. ESS' comments and our responses follow.

### Failure to Maintain Fiscal Records

ESS Comments. ESS disagreed with this finding. ESS said that, while the month-to-month general ledgers were not available, the general ledger for the entire year was available at the school and at a third-party location. ESS stated that Exhibit 3 to its comments was the school's entire general ledger for the 1999 fiscal year.

OIG Response. We changed our finding to address ESS' failure to provide timely access to fiscal records. Based on our review of the records provided, we determined that the records could not be used to support ESS' 90 Percent Rule calculation.

### Dependency Overrides

ESS Comments. ESS stated that the school's "financial aid administrator used her professional judgment in accordance with the law that allows her discretion . . ." to make adjustments to students' application data on a case-by-case basis. ESS said that the type and extent of documentation required to support a professional judgment action is left to the financial aid administrator's discretion and is not specified by law. ESS considered a student's statement or representation to be adequate documentation for a school to use professional judgment and perform a dependency override. The school said that it had reviewed the dependency overrides we questioned and presented Exhibit 4 as its analysis from that review. ESS said it did not believe an audit of all student files is necessary.

OIG Response. We agree with ESS' statement that financial aid administrators are allowed by the HEA to use their professional judgment on a case-by-case basis to adjust application data. However, the HEA also requires financial aid administrators to adequately document the basis for each professional judgment action. We do not agree that ESS adequately documented the basis for the dependency overrides.

Based on our analysis of the documentation in Exhibit 4 for the 27 dependency overrides, we determined that ESS: (1) agreed that no documentation was available for four overrides, (2) did not respond to eight overrides (ESS said it was unable to locate the students' files that the OIG had in its possession), (3) provided documentation for a year other than the one we reviewed for six overrides, and (4) provided documentation that did not support the students were independent for nine overrides (we had reviewed the same documentation during our fieldwork). We provided ESS access to all student files that the OIG seized during the execution of a search warrant in December 2000.

### **Credit Balances**

ESS Comments. ESS said that it believed that it was following the regulations. ESS provided as Exhibit 5 to its comments written authorization forms that the school said it now used.

OIG Response. This information does not alter our finding with respect to credit balances.

### **Apartment Charges**

ESS Comments. ESS disagreed that apartment charges were institutional charges and should have been included in its refund calculations. ESS repeated its assertion that a Department official agreed that apartment charges were a "pass through" and should be excluded.

OIG Response. We have addressed ESS' comments regarding classifying apartment charges under Finding Number 1. ESS provided no additional information in response to this finding that would convince us to change our conclusion. ESS referred to a decision by an administrative law judge which did not in fact contain the quotation attributed by ESS.

## **OTHER MATTERS**

### **Documentation of Loan Cancellation Notifications Not Maintained**

None of the 50 student files sampled contained loan cancellation notifications. ESS informed us that the notifications were issued, but copies of the notifications were not maintained.

Pursuant to 34 CFR §§ 668.165(a)(1), (2) and (3), before an institution can disburse Title IV loan funds, the institution must notify the student of the amount of funds the student can expect to receive, and how and when those funds will be disbursed. The regulations state that if the student's account is credited, the student or parent must be notified so they may cancel all or a

portion of the loan. The notification must be sent no earlier than 30 days before and no later than 30 days after crediting the student's account at the institution.

### **Student Ineligible to Receive Federal Pell Grant**

During our file review of the 132 students ESS claimed had institutional scholarships, we noted that ESS disbursed a \$517 Federal Pell Grant to an ineligible student. The student did not have a high school diploma or its equivalent and had not passed an approved ability-to-benefit (ATB) test.

According to 34 CFR § 668.32(e)(1), a student is eligible to receive Title IV assistance if the student has a high school diploma or its recognized equivalent or has received a passing score on an approved independently administered ATB test.

## **ESS' COMMENTS TO THE DRAFT REPORT**

Although ESS contended that loan cancellation notifications were sent to all 50 of our sample students, the school provided no support for its statement. ESS did agree to change its procedures for documenting such notifications. ESS also agreed to refund the \$517 of Federal Pell Grant funds disbursed to the ineligible student.

## **SUBSEQUENT EVENTS**

Subsequent to our fieldwork, the Department revoked ESS' provisional certification to participate in the Title IV programs on March 27, 2001. ESS requested reconsideration of that decision. The Department denied ESS' request. The school closed on June 29, 2001.

## **BACKGROUND**

ESS, formerly Executive Secretarial School of Texas, was incorporated in 1961. ESS was a proprietary school located in Dallas, Texas. The school received its initial approval to participate in the Title IV programs in December 1969. Due to its high Federal Perkins Loan Program default rate, the Department provisionally certified the school from October 15, 1999, through June 30, 2001. The Accrediting Council for Independent Colleges and Schools accredited the school. The school offered associate degrees in administrative and legal administrative assisting, and vocational programs in paralegal/legal assisting and executive assisting. ESS closed on June 29, 2001.

During the period June 1, 1998, through May 31, 2000, ESS received \$8.7 million in Title IV funds (Federal Pell Grants, FSEOG, FWS, Direct Loans and FFELP).

## **OBJECTIVE, SCOPE AND METHODOLOGY**

The objective of our audit was to determine whether ESS administered the Title IV programs according to selected aspects of the HEA and regulations. Specifically, we reviewed (1) institutional and program eligibility, and (2) selected compliance requirements relating to administration of the Title IV programs, student eligibility, Title IV disbursements, and refunds.

To accomplish our objectives, we obtained and reviewed background information about the school. We reviewed ESS's 1998 and 1999 audited financial statements and compliance audit reports. We interviewed current ESS personnel and students, state licensing agency officials, Department officials, high school counselors, CCST and CTF officials, and the Independent Public Accountant who prepared the school's 1998 and 1999 audited financial statements and compliance audit reports. We also reviewed the Independent Public Accountant's working papers for both financial statement audits and the 1998 compliance audit.

We applied statistical sampling techniques to the universe of 1,227 students by selecting for review a random sample of 50 students who received Title IV funds from July 1, 1998, through May 31, 2000. To evaluate professional judgment, 125 additional students were randomly selected for review for a total of 175 randomly selected students.

We tested the reliability of computerized student records by comparing selected data with source documents such as handwritten attendance rosters and bank statements. For this file review, we concluded that the computerized information was sufficiently reliable for the purposes of our audit. We also obtained data from the National Student Loan Data System (NSLDS).

We reviewed 132 student files for students identified by ESS as having received institutional scholarships to evaluate the validity of the institutional scholarships. For this evaluation, we compared the reliability of computerized student ledgers to other documentation. We concluded that we could not rely on the dates institutional scholarships were recorded as being credited to students' accounts. We obtained and reviewed data applicable to the school from the Department's NSLDS, Postsecondary Education Participants System, Payment Management System, and Grants Administration and Payment System.

We performed our fieldwork from July 17, 2000, through December 19, 2000, at the school's campus in Dallas, Texas. We conducted an exit meeting on November 8, 2000. The school provided additional information on November 22, 2000, and our last visit to the campus was on December 19, 2000. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

## **STATEMENT ON MANAGEMENT CONTROLS**

As part of our review, we assessed the system of management controls, policies, procedures, and practices applicable to the institution's administration of the Title IV programs. We assessed the level of control risk for determining the nature, extent, and timing of our substantive tests. For

the purpose of this report, we assessed and classified the significant controls into the following categories: (1) institutional and program eligibility, (2) student eligibility, (3) Title IV disbursements, and (4) calculation and payment of refunds.

Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in management controls. However, our assessment disclosed weaknesses in the school's procedures relating to calculating the 90 Percent Rule, maintaining fiscal records, performing dependency overrides, obtaining authorizations to retain credit balances, and calculating refunds. These weaknesses are discussed in the AUDIT RESULTS section of this report.



## APPENDIX A

	<b>Explanation for Amounts in OIG 90 Percent Rule Calculation</b>
Title IV Cash Revenue and Total Cash Revenue	We determined Title IV cash revenue by adding all of the total Title IV funds (\$4,517,973) deposited into ESS's Federal funds bank account less \$365,439 of excess cash returned and \$9,736 of administrative cost reimbursement from the Department. We determined the total cash revenue amount by adding the Title IV revenue amount to all of the revenue deposited in the other bank accounts for the year.
Refunds	We determined total refunds by accumulating all Title IV refunds from the ESS bank accounts. The bank accounts contained no non-Title IV refunds. ESS's Chief Executive Officer said its refund amount also included return of excess cash. We excluded excess cash returned from the total Title IV received by ESS prior to making this adjustment (see previous note).
Federal Work-Study	ESS's Title IV revenue amount was not reduced by the Federal portion of FWS program funds. Revenue from the FWS should not be included in the calculation [34 CFR § 600.5 (d)(2)(ii)].
Funds Paid to Students	ESS maintained a separate bank account for funds paid to students. Funds paid to students are not used to satisfy tuition, fees, and other institutional charges and should not be included in either the numerator or denominator of the calculation. Based on our analysis of the bank account, we determined that ESS paid students \$94,507. ESS deducted \$93,834 of funds paid to students from the numerator but not the denominator of its calculation.
Bookstore Income and Apartment Income	The formula requires that cash revenue from tuition, fees, and other institutional charges for students in eligible programs be included in the calculation. ESS's bookstore and apartment charges met the definition of an institutional charge. ESS correctly considered bookstore charges as an institutional cost in calculating refunds but incorrectly excluded revenue from those charges from its 90 Percent Rule calculation. We agree with ESS that the bookstore income was from an institutional charge because students did not have a real and reasonable opportunity to purchase the books from another source. For the 22 sample students who began attending during or before ESS's fiscal year that ended May 31, 1999, the enrollment agreement between ESS and the students always included a charge for books. All of the students obtained books from ESS's bookstore and ESS credited the students' accounts with the book charges. None of the students were provided Title IV funds to purchase the books elsewhere. Because ESS incorrectly considered apartment charges to be a pass-through expense and not an institutional cost, it excluded revenue realized by the charges in both its refund and 90 Percent Rule calculations. We determined the costs were not a pass through expense. ESS leased the apartments but maintained control of them by entering into lease agreements with selected students and determining the charges assessed to the students. ESS earned \$366,243 of cash revenue from leasing the apartments to students. See Finding Number 2 for a further discussion of apartment charges.
Ineligible Revenue	The \$89,696 represents cash revenue from placement fees (\$82,150), corporate training, (\$4,538), and vending machine sales (\$3,008). The formula does not allow revenue from ineligible Title IV programs.
Accounts Receivable Adjustment	The ESS adjustment is the difference in the beginning and ending balances of accounts receivable for the year to convert its accounts from an accrual to a cash basis. No adjustment is needed for our calculation because we considered only cash transactions.



# ESS COLLEGE OF BUSINESS

June 21, 2001

Ms. Sherri Demmel  
 Regional Inspector General for Audit  
 U.S. Department of Education  
 1999 Bryan Street, Suite 2720  
 Dallas, TX 75201-6817

Dear Ms. Demmel

On May 3, 2001, ESS received a *Draft Audit* from the Office of Inspector General that contains the following observation on the cover:

"This draft report is being provided to obtain advance review and comment from those with responsibility for the subjects it discusses, and is, therefore, ***pre-decisional and subject to revision.***" (Emphasis added)

The Draft Audit also contains an EXECUTIVE SUMMARY that recommends that the Chief Operating Officer ("COO") for Student Financial Assistance "determine whether ESS was in compliance with the 90 Percent Rule for its fiscal year 2000."

While the Draft Audit states that it is "pre-decisional" and the COO should "determine whether" ESS complied with 90/10, the decision has been made. A response by ESS to the Draft Audit seems to strain logic when other members of the Department have already decided the issues under consideration and terminated the College's eligibility to participate in Title IV, HEA programs.

The Department placed the institution on cash reimbursement status on December 22, 2000 and on March 27, 2001 acted to revoke the institution's PPA. This decision was apparently a result of the conclusions contained in the *Draft Audit*, which was not delivered to the institution until May 3, 2001. The institution questions the appropriateness of an audit experience that was seriously flawed.

The audit totally ignores the effect of the advice given by the OIG auditor who suggested a search of the files to locate and document institutional scholarships, which could be used to show that the institution was in compliance with the so-called 90 Percent Rule. It further fails to recognize the fatal consequences that result from the fact that the Department refused to reimburse to the College for any of the financial infusion the owners provided between January 1 and March 27, 2001 under the impression that the Department was going to provide reimbursement on a timely manner. The College now

## APPENDIX B

believes that the Office of Inspector General acted in bad faith throughout this period by directing the Department *not to provide any reimbursement*. Nor does this process recognize the disastrous impact of a revocation proceeding that forces the institution into bankruptcy from which there is no opportunity to recover and become whole, should the institution prevail in its efforts to appeal the Draft Audit and have it recognized that the College was never out of compliance.

To demonstrate the extreme confusion and resulting frustration on the part of the institution that existed during the audit, the following excerpts from OIG auditor EDITED workpapers are relevant and worthy of consideration:

EDITED provided the College with the following written calculations and observations -

1. On October 10 she calculated the 90/10 ratio to be 92/8, observing that "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation and *OIG will accept.*" (Emphasis added.)
2. Also on October 10, she calculated the 90/10 ratio to be 88.62/11.38, observing that "This calculation is ESS's and excludes housing income from the 90/10 calculation. ESS and OIG *has agreed to disagree on Apartment Income.*" (Emphasis added.)
3. Also on October 10, she calculated the 90/10 ratio to be 89.78/10.22, observing again that "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90 calculation and the OIG will accept.
4. On October 24, she calculated the 90/10 ratio to be 92.22/7.78, observing that "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation and *OIG will accept.*" (Emphasis added.)
5. Also on October 24, she calculated the 90/10 ratio to be 88.62/11.38, observing that "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation." She also observed that "This (90/10) calculation is ESS's and excludes housing income from the 90/10 calculation. ESS and OIG have agreed to disagree on the Apartment Income."
6. Also on October 24, she calculated the 90/10 ratio to be 89.78/10.22, observing that "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation and *OIG will accept.*" (Emphasis added.)

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7. On November 8, the OIG conducted an exit interview in which they presented their findings to the institution. The 90/10 calculation included in the written material presented to the College *showed that the institution was in compliance using scholarships as an element with a 90/10 calculation with a ratio of 89.78/10.22.*
8. On November 17, EDITED calculated the 90/10 ratio to be 89.23/10.77, again observing, "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation." She also observed that, "This (90/10) calculation is ESS's and excludes housing income from the 90/10 calculation. ESS and OIG have agreed to disagree on the Apartment Income."
9. Again on November 17, she calculated the 90/10 ratio to be 92.8/7.2 again observing that "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation and *OIG will accept.*" (Emphasis added.)
10. Again on November 17, she calculated the 90/10 ratio to be 90.33/9.67, again observing, "Cannot tell how much may be book store income from students. But book store income is \$422,131 per ESS's 90/10 calculation and *OIG will accept.*" (Emphasis added.)
11. On November 20, she calculated the 90/10 ratio to be 88.15/11.85 that included \$171,199.26 in institutional scholarships and showing the institution to be in compliance.
12. On April 9, 2001, she calculated the 90/10 ratio to be 93.58/6.42, observing that "Bookstore income is an institutional charge and *should not be taken out.* This calculation also contains this observation, "*OIG will not accept any institutional scholarships.*" (Emphasis added.)

It appears clear--as the figures above demonstrate--that the lack of specificity regarding the several elements considered as part of the ratio in determining the difference between recognized institutional and non-institutional charges, creates an impossible situation for an institution attempting to comply with the 90 Percent Rule.

The continuously confusing, contradictory calculations of EDITED led the institution to include its scholarships in its 90/10 calculations, with an understanding that following the presentation of the draft audit, the College would be permitted to challenge the findings through an administrative process. The institution and its independent auditors were convinced that the College would prevail under this process. Additionally the institution had been told repeatedly that the Department is not likely to take any action against an institution that is found to be out of compliance by a little bit. Further, EDITED stated that the "OIG will not be requesting that ESS pay back any title IV due to percentages

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being over 90%.” Throughout the audit the institution felt that it was understood that it was acting in good faith by identifying scholarship recipients as requested.

### ESS COLLEGE’S RESPONSE TO THE OIG DRAFT AUDIT

#### FINDING NUMBER 1—ESS DID NOT COMPLY WITH THE 90 PERCENT RULE

ESS is in compliance with the 90/10 Rule for fiscal years 1999, 2000, and 2001. With respect to this issue and FY 1999, ESS fully incorporates into this response as though set forth herein its evidence and argument filed before the U.S. District Court for the Northern District of Texas in the matter of ESS College of Business, Inc., v. Roderick R. Paige, Case No. 3-01CV0723-H and in the Request for Reconsideration of the Decision to revoke the eligibility of the College filed with the Department on April 23, 2001. ESS believes the OIG is in possession of this voluminous material and, therefore, is not submitting copies once again. If this understanding is incorrect, please advise; and we will provide copies of the cited material. The following constitutes a summary of the arguments presented.

After the 85/15 requirement was changed with the Higher Education Amendments of 1998 to 90/10, ED informed the higher education community that this new provision would be made effective with respect to financial statements filed after the October 1998 enactment date. ESS College’s fiscal year 1999 ended on May 31, 1999. Therefore, for purposes of calculating 90/10 for FY 1999, the law and guidance in effect at that time is what should be applied and not the law or interpretations in effect on or after July 1, 2000. In this regard, Dear Partner Letter 99-33, published in October 1999, is relevant. The OIG Dear CPA Letter 99-02, published in November 1999, is of no relevance inasmuch as it represents an interpretation of 90/10 and guidance to certified public accountants issued well after the College’s fiscal year had ended.

Under the 90/10 calculation, an institution includes in the numerator of the fraction Title IV funds received to pay for “tuition, fees, and other institutional charges to student.” 34 CFR 600.5(d). The denominator includes all revenue received to pay for tuition, fees, and other institutional charges. The 1998 regulations that were in effect at the time the College’s fiscal year ended, state that book revenues are not included in the fraction unless they are the result of institutional charges. 600.5(d)(2)(iv). These regulations also state that workstudy are excluded from the numerator but not the denominator, 600.5(d)(2)(ii), and are silent with respect to scholarships and housing revenue.

#### Bookstore Revenue was Properly Excluded from the Calculation

The OIG draft audit includes the bookstore revenue as an institutional charge. In the 1998 regulation, however, it is stated that book revenue was not the result of an

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institutional charge if the institution refers the student to an entity independent of the institution for the purchase of the books. The issue, as explained in the January 1999 Policy Bulletin on institutional charges, is not whether the institution actually charged the student on the student's account. The issue for purposes of analyzing book revenue is whether the student has a "real and reasonable opportunity" to purchase the required material from any place but the institution.

The Bulletin further states that the institution needs to demonstrate that the books were available for purchase at a relatively convenient location unaffiliated with the institution and that the institution did not restrict the availability of financial aid (federal, state, institutional, or other scholarship, grant, or loan funds) to students so that they could exercise this option.

As the OIG recognized for nearly the entire audit period, ESS students had a real and reasonable opportunity to buy their books at other locations. This included the opportunity to buy the required books at comparable prices at Southern Methodist University's Umphrey Lee Center in Dallas, about five minutes from the College; at a privately owned bookstore (Half Price Books at 5803 East NW Highway, Dallas) about ten minutes from the College; and at Brookhaven Bookstore at 4099 Brookhaven Club Drive, Dallas, which is part of the Dallas County Community College, about fifteen minutes from the College. In addition, students could and did buy the same books on the internet from Barnes and Noble Bookstores, among others.

The privately owned bookstore routinely put flyers on student's cars parked in the College parking lot advertising an interest in buying and selling textbooks. Students who purchased books from the College could use a line of credit. Students who wanted to buy their books elsewhere could obtain an advance in cash, if needed, from the College. Furthermore, the College affirmatively told students that books may be purchased elsewhere. In all lists given to students describing textbooks required, the College informed the students that they "may" purchase textbooks on campus.

As such, ESS College students had a "real and reasonable opportunity" to buy their books elsewhere and the revenue resulting from purchases from the College bookstore were not the result of an institutional charge. Thus, the bookstore revenue should not be included in the 90/10 calculation.

Up to and including the exit audit interview, the OIG auditor accepted these facts. However, when the College received the Revocation Letter in March 2001, it discovered that the OIG included the bookstore revenue as an institutional charge. No valid basis exists for this last minute change in position.

### Housing Revenue was Properly Excluded from the Calculation

The regulations in effect for the period June 1, 1998, to May 31, 1999, that address room and board and whether it is an institutional charge are set forth in the refund provision of the Department's regulations. The regulations provided that a fair and equitable refund

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policy “makes a refund of unearned tuition, fees, room and board, and other charges.” 34 CFR 668.22(a)(1)(1998). The regulation further states that “Room charges do not include charges that are passed through the institution from an entity that is not under the control of, related to, or affiliated with the institution.” 34 CFR 668.22(c)(6)(i)(1998).

Clearly, room charges are not necessarily institutional charges. The January 7, 1999, Policy Bulletin discussed in the prior section states that institutional costs are defined as expenses that a school assesses a student for educational expenses that are paid directly to the school. It also specifically states that

“a charge to the student’s account for room charges that are collected by the school but are ‘passed through’ to an unaffiliated entity” are **noninstitutional costs.**”

In the most recent Department of Education conducted program review at ESS, the team leader, EDITED, correctly determined that room charges at ESS are excluded from the refund policy and thus are a “pass through.” The institution concurs with EDITED since the regulation states “a charge to the student’s account for room charges that are collected by the school but are ‘passed through’ to an unaffiliated entity are non-institutional costs.” The institution should not be penalized for its good faith interpretations of departmental policy and for acting in accordance with the similar interpretations and directions of ED’s agents. Also in ED’s Interim Final Regulations with Invitation for Comment, the Secretary stated, that

“The Secretary believes certain costs (i.e. passed-through room charges, and group health insurance fees) warrant treatment other than standard proration and has therefore specifically named such costs and proposed that they be **excluded** from calculation.” 59 Fed. Reg. 22348, 22396 (April 29, 1994).

Based on this guidance, ESS College concluded correctly that it could exclude the revenue received for housing from the 90/10 calculation because the housing was not under the control, related to or affiliated with ESS College or any of its principals and because the rent collected from the students was passed through to the various landlords. The College merely facilitated housing as convenience to the students from out of town.

### Federal Work Study Funds

ESS properly included Federal Work Study Funds as revenue in the denominator. The regulations in effect for fiscal year 1999 clearly state that “Title IV, HEA program funds included in the numerator do not include ... Federal Work Study program funds.” 34 CFR 600.5(d)(2)(ii)(1998). The regulatory discussion about what is excluded from the denominator of the fraction does not mention Federal Work Study. Likewise, the preamble discussion of this point from 1994 made the same statement. 59 Fed. Reg. 28 at 6449 (2/10/94). In fact, not until July 1, 2000, was any regulation or rule in place that stated that FWS is to be excluded from the denominator of the fraction, as well.

## APPENDIX B

ESS College properly included \$22,022 in FWS in the denominator of the fraction for purposes of its 90/10 calculation in FY 1999 based on all available law and guidance. The OIG has improperly excluded it based on subsequent regulatory language.

### Scholarship Revenue was Properly Included in the Calculation

ESS properly included scholarships awarded to students attending ESS. Dear Partner Letter GEN-99-33 announced standards to be used prospectively to review 85/15 and 90/10 eligibility calculations. GEN-99-33 was written because, as it says, of “some differing interpretations within the higher education community of the standards used to determine whether institutional scholarships... may be included in a proprietary school’s 85/15 eligibility calculation.” This Letter made it clear that institutional scholarships could be included in the calculations until July 1, 2000, even if the programs did not meet cash-based accounting standards.

The OIG has no basis to challenge the legitimacy of the CCST and CTF scholarship programs. Furthermore, there can be no doubt that ESS actually awarded all of the scholarships that are of issue. The simple issue is whether they can be treated as scholarships awarded for FY 1999 and even if agreement cannot be reached on all scholarship awarded by ESS for FY 1999, there should be no doubt that some portion of the scholarship revenue can properly be included in the FY 1999 calculation. This includes, among others, students who enrolled at ESS with scholarship certificates from CCST or CTF that were received and accepted by the College in fiscal year 1999 but as to which ESS did not make the record entry until after the fiscal year ended.

As to these scholarships, no credible basis exists to claim manipulation of the record, as alleged by the OIG. Rather, ESS’ actions reflect an entry in the record of what happened at the time but which was not recorded at the time. This is neither a sinister nor invalid act; the correction of a record is something businesses and even the government does. The amount of \$70,000 in CCST and CTF scholarships, we believe, should be included.

Exhibit 1 demonstrates the College’s compliance with the 90/10 calculation for FY 2000 as supported by statements from Salmon, Beach & Company, P.C. This calculation bases the federal funds amount on the institution’s record of federal funds received; however, in the draft audit of May 2001, the ED-OIG states that the institution received in 1999/2000 a total of \$4,379,550 of Title IV. The auditors used our number, and under Exhibit 1 is an additional calculation using the Department’s figure.

Exhibit 2 is the calculation for FY 2001 (fiscal year 2001 covers the abbreviated period of June 1, 2000, through March 27, 2001, at which time the institution was decertified), using both the institution’s understanding of the correct methodology and the methodology used by the OIG, which the institution contends is incorrect. Under either methodology, ESS College was in compliance.



**FINDING NUMBER 2—ESS LACKED ADMINISTRATIVE CAPABILITY****Failure to Maintain Fiscal Records**

This citation is untrue. The school's Chief Executive Officer reported that she disposed of the month-by-month general ledgers for fiscal year 1999. However, she had on disk and stored on her computer the entire fiscal year's general ledger. Further, this general ledger is maintained permanently at a third party location, Varsity Computing. She offered to print the entire ledger or only the accounts needed. The OIG auditor requested certain accounts, which were printed for her. The general ledger for fiscal 1999 is attached as Exhibit 3. In addition all records relating to its administration of the Federal Perkins Loan, FWS, FSEOG, FFEL, Direct Loan, or Federal Pell Grant Programs are maintained for three years as required according to 34 CFR 668.24(e)(1)(2).

**Dependency Overrides Without Adequate Documentation**

The Higher Education Act expressly permits the financial aid administrator, "on the basis of adequate documentation, to make adjustments on a case by case basis to the cost of attendance or values of the data items required to calculate the expected student or parent contributions ... to allow for treatment of an individual eligible applicant with special circumstances. 20 USC 1087tt. Consistent with this language ED stated in 1993 that decisions to override a student's dependency status must be made on a case-by-case basis, based on an individual student's unusual circumstances, and must be documented in the student's file. Dear Colleague Letter GEN-93-11, April 1993, Q&A #2. As such, it is clear, that the question is whether the financial aid administrator abused his or her discretion.

The financial aid administrator used her professional judgment in accordance with the law that allows her discretion to adjust on a case-by-case basis. The financial aid administrator did not adjust any student's Estimated Family Contribution. The type and extent of documentation required is also left to the administrator's discretion and is not specified by law. Only documentation that satisfies the financial aid administrator as stated in ED's verification guide is required.

It is the contention and belief of the institution that a student's statement or representation is adequate documentation. If a student's statement is adequate for verification of a student's income, household size, number of family members in college, non-tax filer status, untaxed income and benefits, proof of high school graduation or GED then it should be fairly obvious that a student's statement should be acceptable for dependency override. Again, we must note that there is no regulation that addresses the specific documentation needed for dependency overrides. During and prior to the exit interview, the OIG auditor stressed the need for additional documentation. The institution has reviewed the files questioned by the OIG. Exhibit 4 is an analysis of the documentation that the financial aid administrator used for determining dependency overrides. Further,

the OIG should take note of Chief Judge Canellos' decision on this matter, which is supportive of ESS' position, In the Matter of Saint Louis University, Student Financial Assistance Proceeding, DKT. No. 99-29-SA; ACN: 06-96-70003 U.S. Department of Education (May 25, 2000). Accordingly, the institution does not believe that an audit of all student files is necessary or appropriate.

### **Credit Balances Retained Without Students' Authorization**

The institution believed that they were following the regulations by utilizing the financial aid confirmation form. Prior financial aid audits had not noted the need for a new form. The first time the financial aid director became aware of the need for a new form was when the auditor (OIG) brought it to her attention. Additionally, later in the year the auditor for the annual compliance audit recommended a more extensive form be used. Exhibit 5 is now used to obtain written authorization from students to retain credit balances.

### **Apartment Charges Not Included in Refund Calculations.**

The institution has been following the procedures outlined by the Department of Education's last compliance audit in August 1998. The team leader, EDITED , explicitly reviewed the apartment charges and recommended the procedures that the institution has followed. Evidently, the OIG and Department of Education are not in agreement on this issue. As noted by EDITED , the Department agreed with the College that the apartment revenue was a pass-through and not an institutional charge. See also In the Matter of Saint Louis University, Student Financial Assistance Proceeding, DKT. No. 99-29-SA; ACN: 06-96-70003 U.S. Department of Education (May 25, 2000) 2000 EOHA Lexis 5 in which the Secretary stated as follows:

"The Secretary recognizes that an institution may enter into an agreement with an outside agency to provide lodging for students. Under such an arrangement, the institution is merely a conduit that passes the room charges along to the other entity, yet those charges appear as institutional charges on student accounts. In these cases, the independence of the entities and students' continuing right to occupy the housing after the students withdraw warrant the exclusion of the room charges from the refund calculation."

### **OTHER MATTERS**

#### **Documentation of Loan Cancellation Notifications Not Maintained.**

All of the 50 student files had been sent loan cancellation notifications, which is contrary to the finding. The regulations do not specify what type of documentation is required.

## APPENDIX B

The OIG auditor requested that certified letters be sent. The institution agreed to those changes in documentation.

### **Student Ineligible to Receive Federal Pell Grant.**

The student in question is EDITED who entered the College on August 3, 1998, having marked on his entrance papers that he was a high school graduate. The College dismissed EDITED on August 27, 1998, after requesting his high school transcript and noting that he was not a high school graduate. EDITED had completed all required courses for graduation; however, in Texas one must not only complete the course work but also pass the TAAS test. EDITED lacked a passing grade on his TAAS but incorrectly believed that he was a high school graduate. During this three-week period prior to receiving word that EDITED was not a high school graduate, a PELL grant for \$517 was incorrectly awarded to him. The institution agrees that a refund of \$517 is due.

The institution reserves the right to provide further documentation as the review of this draft audit continues.

Sincerely



Jan V. Friedheim  
Chairman of the Board

Copy of Exhibits



## UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202- \_\_\_\_\_

MAR 27 2001

Mr. Steven B. Friedheim  
 President  
 ESS College of Business  
 4849 Greenville Avenue, Suite 200  
 Dallas, TX 75206-4125

SENT BY REGISTERED MAIL  
 RETURN RECEIPT REQUESTED

OPE-ID: 00943200

Dear Mr. Friedheim:

The Secretary of Education (Secretary) has determined that ESS College of Business (ESS) has failed to meet its responsibilities under its provisional program participation agreement (PPA). 34 C.F.R. §668.13(d)(1). As a result, the provisional certification that the Department of Education (Department) granted to ESS on October 15, 1999 is hereby revoked. With this revocation, the institution's PPA ends, effective the date of this letter, which is also the date of its mailing. 34 C.F.R. §668.13(d)(2)(ii). Following the expiration of a PPA, an institution may no longer participate in the student financial assistance programs authorized pursuant to Title IV of the Higher Education Act of 1965, as amended, 20 U.S.C. §1070 et seq. and 42 U.S.C. §2751 et seq. (Title IV, HEA programs). 34 C.F.R. §668.26(a)(4).

In particular, with the mailing of this letter, ESS is no longer eligible to participate in the following Title IV, HEA programs: Federal Pell Grant (Pell Grant), Federal Supplemental Education Opportunity Grant (FSEOG), Federal Work-Study (FWS), Federal Perkins Loan (Perkins Loan), Federal Direct Student Loan (Direct Loan), and the Federal Family Education Loan (FFEL) programs. The Direct Loan Program includes the Federal Direct Stafford Loan Program, the Federal Direct Student Unsubsidized Stafford Loan Program, and the Federal Direct PLUS Program. The FFEL Program includes the Federal Stafford Loan Program (Stafford Loan), the Federal PLUS Loan Program (PLUS), and the Federal Consolidation Loan Program (CL). The FSEOG, FWS, and Perkins Loan programs are known as the campus-based programs.

In addition, with this revocation, ESS is responsible for complying with each regulatory requirement that has been established for institutions that end their Title IV participation. 34 C.F.R. §668.13(d)(2)(iii). Specifically, among other itemized responsibilities, ESS must submit to the Secretary within 45 days of this revocation, all financial, performance, and other reports required by the Title IV regulations, as well as a letter of engagement for an independent audit of all funds that the institution received under the Title IV programs. 34 C.F.R. §668.26(b)(2). This closeout audit report is to be submitted within

45 days after the date of the engagement letter. 34 C.F.R. §668.26(b)(2)(ii). In addition, ESS shall inform the Secretary of the arrangements it has made for the retention and storage of its records. 34 C.F.R. §668.26(b)(3). Moreover, ESS must continue to distribute refunds according to 34 C.F.R. §668.22. 34 C.F.R. §668.26(b)(7).

To participate in the Title IV, HEA programs, an institution must demonstrate to the Secretary that it qualifies to be certified to participate in those programs under 34 C.F.R. Part 668, Subpart B. Specifically, an institution must meet the standards of administrative capability set forth at 34 C.F.R. §668.16, and the standards of financial responsibility set forth at 34 C.F.R. §668.15. Moreover, it is axiomatic that an institution must satisfy definitional prerequisites of institutional eligibility to continue to receive Title IV, HEA program funds. 34 C.F.R. §668.13(a)(1).

To satisfy the standards of administrative capability, an institution must demonstrate to the Secretary that it is capable of adequately administering the Title IV, HEA programs. Its "capability" must be measured within the context of a fiduciary standard of conduct. In particular, to participate in the Title IV, HEA programs, an institution must at all times act with the competency and integrity necessary to qualify as a fiduciary. 34 C.F.R. §668.82(a). In the capacity of a fiduciary, an institution is subject to the highest standard of care and diligence in administering the Title IV, HEA programs, and in accounting for the funds received under those programs. 34 C.F.R. §668.82(b)(1). After evaluating the actions and integrity of ESS during its operation, the Secretary concludes that ESS has failed to fulfill its fiduciary responsibilities necessary to continue to receive Title IV, HEA program funds.

By executing a provisional PPA, ESS affirmed that it would comply with all applicable regulatory and statutory provisions governing the administration of the Title IV, HEA programs. (See Enclosure 1.) ESS also expressly agreed that a cause for revocation included, "without limitation", among other things, "a violation of Department regulations deemed material by the Department". (*Id.*) Here, ESS intentionally manipulated its student and financial data to attempt to deceive the Department into believing that ESS complied with the so-called "90-10 rule". This rule establishes that institutions must obtain no more than 90 percent of their revenues from Title IV, HEA program funds. 20 U.S.C. §1002(b)(1)(F); 34 C.F.R. §600.5(a)(8), (d). In this case, ESS' misconduct constitutes a material violation of Department regulations and warrants this revocation action. In addition, ESS is statutorily ineligible for additional Title IV revenues as a result of its noncompliance with the 90-10 rule.

## **I. BACKGROUND**

On July 17, 2000, the Department's Office of Inspector General (OIG) began a routine audit at ESS. Incident to this audit, in the normal course, the OIG requested a copy of ESS' 90-10 calculation. ESS provided the calculation found in its 1999 financial statements showing that the school complied with the 90-10 rule. Specifically, the

calculation showed that 79.17 percent of ESS' total revenue came from Title IV sources, well below the 90 percent threshold.

To evaluate the legitimacy of this calculation, the OIG analyzed all of the school's bank accounts. As a result of this examination, certain problems with the calculation emerged, and the OIG concluded at that time that ESS received 92.85 percent of its total revenue from Title IV sources for the period June 1, 1998 through May 31, 1999, or for its 1999 fiscal year.

As a result, on October 2, 2000, the OIG met with Jan Friedheim, ESS' Chairman of the Board, to discuss the 90-10 calculation, and to tell her of the school's failure. Mrs. Friedheim stated that she would review the school's bank accounts, as well as various student ledgers, to determine if institutional scholarships may have been awarded to students that heretofore had not been considered by ESS as part of its 90-10 calculation.

Two days later, on October 4, 2000, Mrs. Friedheim contacted the OIG and stated that she had found 54 student ledgers that reflected institutional scholarships, despite the fact that prior to October 2, 2000, ESS officials had made no mention of such student scholarships.

One week later, on October 11, 2000, the OIG auditor returned to the school to review relevant student file documentation concerning these 54 students. Mrs. Friedheim provided the auditor with a computer-generated list entitled, "1998/1999 ESS Scholarships" that contained the names of 60 students who purportedly received one or more institutional scholarships. She also gave the auditor 67 student files. From these files, the auditor added an additional seven student names to the list and excluded one student since that student's scholarship was awarded outside the 1999 fiscal year. The remaining 66 students were identified as receiving a total of \$87,000 in scholarships. In particular, these students supposedly received ESS Scholarships called an "Imagine America Scholarship" provided by the Career Training Foundation (CTF) and/or the Career Colleges and Schools of Texas (CCST).<sup>1</sup>

Following the receipt and acceptance of these scholarships, the OIG recalculated ESS' 90-10 ratio. On October 18, 2000, the auditor contacted Mrs. Friedheim and advised her that with the inclusion of this information, the OIG had now determined that ESS received 89.78 percent of its revenue from Title IV sources, and thus the school was back in compliance with the 90-10 rule.

Several weeks later, however, the OIG again internally reviewed ESS' 90-10 calculation. At this point, the OIG determined that ESS' calculation remained in error. In particular, ESS had not properly removed FWS funds from its calculation, and previously, the OIG had inadvertently excluded these funds from only the numerator, and not the

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<sup>1</sup> In addition, one other student received a legitimate Workforce Initiative Act scholarship from Dallas County valued at \$5,510 during ESS' 1999 fiscal year. For purposes of this action, only the CTF and CCST scholarships are at issue.

denominator, of ESS' calculation. See 34 C.F.R. §600.5(e)(1)(i). As a result, the OIG concluded that ESS, in fact, derived 90.33 percent of its revenue in 1999 from Title IV sources, even with the addition of all of the supposed scholarship money. On November 17, 2000, the OIG advised Mrs. Friedheim of its opinion.

Five days later, on November 22, 2000, ESS delivered to the OIG an envelope with 64 additional computer-generated student ledger sheets, along with copies of scholarships totaling \$76,000 claimed to have been received by these 64 ESS students. The envelope also contained a new calculation that Mrs. Friedheim had prepared showing that ESS received 88.45 percent of its revenue from Title IV sources for its 1999 fiscal year.

Given these newly-appearing scholarships, the OIG auditor contacted Mrs. Friedheim again on November 30, 2000, to advise her that auditors would be returning to the school to review the files of the students on the list just provided. In addition, the auditor advised Mrs. Friedheim that she wanted to revisit the files of the 66 students from the October 11, 2000 list, for a total of 130 files to be examined.

On December 6, 2000, OIG auditors returned to ESS to review student records. As a result of the significant numbers of apparently falsified entries and fictitious documents that the OIG found at this time, probable cause was established to obtain a search warrant to seize ESS' financial aid records. On December 19, 2000, federal agents executed this warrant.

Subsequent to its onsite efforts, the OIG has concluded that ESS received 93.58 percent of its revenues from Title IV funds during its 1999 fiscal year. Specifically, the OIG determined that ESS had \$4,142,798 in Title IV cash revenue in 1999 by adding all of the total Title IV funds deposited into ESS' Federal funds bank account, less \$365,439 of excess cash returned, and \$9,736 of administrative cost reimbursements received from the Department. The OIG further subtracted from this total \$373,648 in Title IV refunds identified in ESS' bank accounts. The OIG also subtracted \$22,022 that consisted of the Federal portion of ESS' FWS program funds. Finally, the OIG subtracted \$94,507 in Title IV funds paid directly to students for living expenses from a separate bank account that ESS maintained for this purpose. This resulted in a net Title IV total of \$3,652,621 to be used in the numerator of the 90-10 calculation. For purposes of the denominator, the OIG determined the total cash revenue received by ESS by adding the total Title IV revenue to all of the revenue deposited in other ESS bank accounts. This equaled \$4,483,069. From this total, the OIG subtracted the above-mentioned three categories of funds (Title IV refunds, FWS monies, and living expense funds), plus an amount of ineligible revenue equal to \$89,696. This final category consisted of revenue from placement fees (\$82,150), corporate training (\$4,538), and vending machine sales (\$3,008). The end result was a denominator of \$3,903,196 for a 90-10 ratio of 93.58 percent.<sup>2</sup>

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<sup>2</sup> In a meeting that was requested by ESS, and held on March 19, 2001, ESS, among other things, attempted to rebut the adverse 90-10 finding by suggesting that one additional form of Title IV revenue-- money that was used by students to pay apartment rent-- should be excluded from its 90-10 calculation. The principle basis for this argument was that student room charges are allegedly "passed through" to an

## II. ESS CONTINUALLY GENERATED NEW DOCUMENTS IN A DELIBERATE ATTEMPT TO DECEIVE THE DEPARTMENT AND THE OIG

It is incontrovertible that as a result of the ongoing exchange between ESS officials and OIG auditors, as well as the long-time Title IV knowledge and involvement of Mrs. Friedheim, ESS was acutely aware of the importance of complying with the 90-10 rule. Specifically, an institution that fails to satisfy this requirement loses its Title IV eligibility on the last day of the institution's fiscal year during which the failure occurred. 34 C.F.R. §600.5(g). Institutions that fail to meet the 90-10 rule must cease awarding Title IV aid and comply with the close-out provisions found at 34 C.F.R. §668.26.

Apparently, because ESS could not legitimately satisfy the 90-10 rule, it engaged in a pattern and practice of deceptive behavior.

For purposes of this action, the Department acknowledges that CTF and CCST offer a scholarship that may be received by high school graduates to attend certain proprietary schools. ESS is one of those proprietary schools.<sup>3</sup> In addition, for the limited purpose of this action only, the Department acknowledges that these scholarships may count as non-Title IV revenue for calculating the 90-10 ratio in 1999.<sup>4</sup> The following criteria govern the CTF and CCST scholarships:

- (1) The awardees must be high school graduates who receive the scholarship directly from their high school;
- (2) Each high school selects whatever criteria it may choose to award this scholarship; and
- (3) The student takes the scholarship to a participating proprietary school of his/her choice, which then credits the student's account during the student's enrollment.

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unaffiliated entity thus making them noninstitutional costs. However, the materials that ESS provided to the Department to support its position were evaluated and found wanting. In particular, ESS contracts with landlords to secure available housing. Subsequently, ESS separately contracts with its students to lease this acquired housing. It is the contract between ESS and the student that governs the student's rights and responsibilities, and it is this contract that establishes the charges the student pays. The student effectively has no dealings with the original landlord whatsoever. Thus, the money that an ESS student pays for board falls squarely within the defined rule that board charges are institutional costs. As a result, ESS' argument to change its 90-10 calculation is rejected. Furthermore, even if this apartment revenue was excluded from ESS' 90-10 calculation, ESS would still exceed the 90 percent limit on Title IV receipts. In addition, the other information provided by ESS at this meeting did not change the contrary findings otherwise outlined in this letter.

<sup>3</sup> CCST has offered scholarships for students graduating from Texas high schools since 1997. CTF adopted this same program to offer scholarships nationally beginning in 1998.

<sup>4</sup> Under no circumstances, after July 1, 2000, would these scholarships count as non-Title IV revenue for 90-10 calculation purposes.



Here, the Department has found that ESS did not offer a single legitimate CTF or CCST scholarship to any one of its students during its 1999 fiscal year. Rather, ESS generated documents with the desire and expectation that it would be permitted to continue to receive Federal funds.<sup>5</sup>

In particular, the OIG determined the following in its review of the 129 students that ESS claimed to have been CTF or CCST scholarship recipients<sup>6</sup>:

(1) Twelve students were not high school graduates, and thus were ineligible for this particular scholarship. Moreover, since this scholarship must be acquired by a student from his/her high school to be presented at a postsecondary school, these scholarships could not have been obtained by students from high schools from which they graduated. Rather, ESS created them without justification.<sup>7</sup>

(2) Forty-two students graduated from Texas high schools before 1997, the year when the scholarship program began. Again, since this scholarship is obtained by a student from his/her high school following graduation, students could not have secured these scholarships at a time prior to their existence. Once again, they were the creation of ESS.<sup>8</sup>

(3) Four students were high school graduates, but were graduates from a state other than Texas, and yet supposedly received CCST scholarships. Needless to say, these students did not receive a Texas scholarship from high schools in Arkansas, California, and even outside the United States, as ESS claimed.<sup>9</sup>

(4) Eight students have scholarships listed in their married name, even though they were single, and had their maiden name, at the time of their high school graduation.<sup>10</sup>

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<sup>5</sup> ESS' audited financial statements for 1999, submitted to the Department in accordance with 34 C.F.R. §668.23(d)(1), do not make any reference to ESS awarding scholarships. In particular, these financial statements do not contain a separate line item for scholarships, do not refer to scholarships within the "Notes" to the statements, and do not otherwise identify scholarships as part of the school's accounts receivable.

<sup>6</sup> Enclosure 2 is a listing of the 129 scholarship recipients, and identifies at least some of the ways in which these scholarships are invalid. This number is one less than the 130 students previously mentioned because Mrs. Friedheim provided the name of one student twice.

<sup>7</sup> "Reason Code #1" on Enclosure 2 identifies these 12 students.

<sup>8</sup> "Reason Code #2" on Enclosure 2 identifies these 42 students.

<sup>9</sup> "Reason Code #3" on Enclosure 2 identifies these four students.

<sup>10</sup> Student #12's maiden name was "EDITED", which also is the name on her high school diploma. Nonetheless, her scholarship contains her married name, "EDITED". Student #25's maiden name was "EDITED", which is the name listed on her high school diploma. Her scholarship contains her married name, "EDITED". Student #45's maiden name was "EDITED", which is the name listed on her high school

(5) Sixty-one students had ledger sheets in their files that the OIG copied as part of its audit. None of these sixty-one ledgers identify a scholarship as having been awarded during the 1999 fiscal year as ESS now claims.<sup>11</sup> Subsequently, ESS submitted different documents to the OIG, which include a scholarship where none was previously listed. These ledgers were simply backdated in an effort to make them represent something contrary to what in fact occurred.<sup>12</sup>

(6) Sixty-one students had promissory notes in their files-- signed by the student upon his/her departure from the school-- that the OIG copied as part of its audit. All sixty-one state an amount owed to the school that does not reflect the student's scholarship. Most of these promissory notes have subsequently been altered-- in pencil-- to suggest purportedly a reduction in the amount owed equal to the scholarship. Of course, all of these alterations-- which do not legally affect the actual note signed-- would not have been necessary had the scholarships really been awarded as is now claimed.<sup>13</sup>

(7) Thirty-six students had collection notices in their files that the OIG copied as part of its audit. None of these thirty-six notices presented a demand for payment that reflect the award of a CCST or CTF scholarship. Once again, had ESS actually awarded scholarships in 1999 as it now claims, its demands for payment would have been reduced by an amount equal to the scholarship.<sup>14</sup>

(8) Sixty-six students dropped from their program of instruction, necessitating the potential calculation of a tuition refund. Sixteen of these students attended ESS for a sufficient period of time so that they were not eligible for a refund, and no refund calculation was done.<sup>15</sup> In the remaining 50 cases, in not a single instance

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diploma. Her scholarship contains her married name, "EDITED". Student #55's maiden name was "EDITED" which also is the name on her high school diploma. Nonetheless, her scholarship contains her married name, "EDITED". Student #59's maiden name was "EDITED", which is the name listed on her high school diploma. Her scholarship contains her married name, "EDITED". Student #88's maiden name was "EDITED", which also is the name on her high school diploma. Nonetheless, her scholarship contains her married name, "EDITED". Student #101's maiden name was "EDITED", which is the name listed on her high school diploma. Her scholarship contains her married name, "EDITED". Student #110's maiden name was "EDITED", which also is the name on her high school diploma. Nonetheless, her scholarship contains her married name, "EDITED".

<sup>11</sup> The OIG did not find a single ledger sheet that reflected properly an award of a CCST or CTF scholarship during the 1999 fiscal year.

<sup>12</sup> "Reason Code #4" on Enclosure 2 identifies these 61 students.

<sup>13</sup> "Reason Code #6" on Enclosure 2 identifies these 61 students.

<sup>14</sup> "Reason Code #7" on Enclosure 2 identifies these 36 students.

<sup>15</sup> This applies to the following students: #s 1, 17, 18, 25, 27, 55, 61, 73, 76, 77, 80, 82, 83, 96, 114 and 119.

was the student's purported scholarship initially included in ESS' refund calculation. In 42 cases, ESS subsequently altered the form-- in pencil-- to reflect purportedly a credit for the scholarship.<sup>16</sup> In the other eight cases, ESS neglected to make this alteration.<sup>17</sup> Again, had ESS awarded scholarships in 1999 like it presently claims, these awards would have been part of the refund calculation when it was initially performed.

(9) Fifteen students did not have a copy of their scholarship in their file. Since this is a document that the student must independently acquire, and then present to the institution to receive appropriate credit, one would anticipate that this record would be kept to verify the student's entitlement.<sup>18</sup>

(10) The remaining 115 students had a copy of a purported scholarship in their file that was not the actual scholarship form provided by CCST and CTF for high schools to use during ESS' 1999 fiscal year.<sup>19</sup> These students did not secure from their high school a scholarship form different from the one that had been distributed by the salient organizations to be awarded that year.<sup>20</sup>

As previously mentioned, an essential aspect of an institution's fiduciary conduct is its exhibition of integrity in its continuing relations with the Department. If an institution manifests untrustworthiness, it must forfeit its opportunity to continue to receive Title IV, HEA program funds. Here, ESS has engaged in fraudulent conduct. If an institution cannot be trusted to perform the most elemental tasks, such as providing true and accurate information to support its 90-10 calculation, the institution lacks the ability to act as a fiduciary, and thus cannot satisfy the standards of administrative capability. Moreover, in this case, ESS is institutionally ineligible as a result of its noncompliance with the 90-10 rule. Therefore, ESS' provisional PPA is hereby revoked.

ESS may request reconsideration of this revocation by submitting to the Secretary, **no later than 20 days following receipt of this notice**, written evidence to show that the revocation is unwarranted. 34 C.F.R. §668.13(d)(3)(i). Should ESS elect to pursue this option, please submit written materials to:

Mary Gust, Director  
Administrative Actions and Appeals Division  
U.S. Department of Education

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<sup>16</sup> "Reason Code #9" on Enclosure 2 identifies these 42 students.

<sup>17</sup> This applies to the following students: #s 33, 36, 38, 53, 56, 99, 115 and 128.

<sup>18</sup> "Reason Code #8" on Enclosure 2 identifies these 15 students.

<sup>19</sup> One student-- #61-- is listed in both this and the immediately preceding category because she purportedly received both a CTF and a CCST scholarship, and her file did not contain the CTF form, but did contain the erroneous CCST form.

<sup>20</sup> "Reason Code #5" on Enclosure 2 identifies these 115 students.

400 Maryland Avenue, SW  
ROB-3, Room 3923  
Washington, DC 20202

Should ESS elect to submit written materials by facsimile transmission, the number to be used is (202) 401-3426. Contemporaneous with such a transmission, the institution is responsible for mailing a hard copy of the same materials to the above-address. The Secretary discourages the use of facsimile transmissions for documents longer than five pages. 34 C.F.R. §668.13(d)(3)(iv).

The Secretary's designated official will promptly consider ESS' request for reconsideration and will notify the institution by certified mail, return receipt requested, of the decision. 34 C.F.R. §668.13(d)(4)(i). If the revocation remains in effect, the institution may not apply for reinstatement of its Title IV participation until after the expiration of eighteen months following the effective date of the revocation. 34 C.F.R. §668.12(d)(4)(ii)(A).

If you have any questions regarding this letter, you may contact Nan Shepard at (202) 401-0148.

Sincerely,



M. Geneva Coombs  
Director  
Southwest Case Management Division  
Case Management and Oversight

Enclosures

cc: Charles Johnson, Area Case Director, Dallas Case Team  
Sherri Demmel, Regional Inspector General for Audit  
Mary Gust, Director, Administrative Actions and Appeals Division  
Russell Wolff, OGC

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**Auditee**

Mr. Steven B. Friedheim, President  
ESS College of Business

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**Action Official**

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**Other ED Offices**

Chief of Staff, Office of the Secretary 1  
Deputy Secretary, Office of the Deputy Secretary 1  
Under Secretary, Office of the Under Secretary 1  
Director, Office of Public Affairs 1  
General Manager for Schools, Student Financial Assistance 1  
Chief Financial Officer, Student Financial Assistance 1  
Director, Case Management and Oversight, Student Financial Assistance 1  
Area Case Director, Dallas Case Management Team  
Case Management and Oversight, Student Financial Assistance 1  
General Counsel, Office of the General Counsel 1

**Office of Inspector General**

Inspector General 1  
Deputy Inspector General 1  
Assistant Inspector General for Analysis and Inspections 1  
Assistant Inspector General for Investigation 1  
Assistant Inspector General for Audit 1  
Deputy Assistant Inspector General for Audit 1  
Director, Student Financial Assistance 1  
Regional Audit Offices 6  
Dallas Regional Office 6

**Others**

Texas Workforce Commission 1  
Texas Guaranteed Student Loan Corporation 1  
Accrediting Council for Independent Colleges and Schools 1